

DEFERRED COMPENSATION **INVESTMENT SUBCOMMITTEE**

MINUTES

Wednesday, April 23, 2008

The Deferred Compensation Ad-Hoc Investment Sub-Committee meeting was called to order at 9:40 a.m. on Wednesday, April 23, 2008, City Hall, Wing, W-260

Roll Call

Donna Busse
Julia Cooper
Conrad Taylor

Management Employees' Representative (392-6709)
City Manager's Representative (535-7011)
Police Representative (POA 277-4012)

Also Present

Suzanne Hutchins
Jeanne Groen
Cheryl Boston
Bill Tugaw

Attorney
Human Resources, Deferred Compensation Secretary
Human Resources, Deferred Compensation Staff
Consultant, SST Benefits (650)940-1111

AGENDA

9:30 – 11:00 A.M.

April 23, 2008

City Hall, W-260

APPROVAL OF MINUTES

1. M.S.C. (Busse/Taylor) to approve minutes for the April 1, 2008 meeting.

OLD BUSINESS

1. Review and discuss revised draft Investment Policy and Procedures Statement.

Bill Tugaw explained prior discussions with the Deferred Compensation Advisory Committee (DCAC) and previous Investment Subcommittee led to a desire to review and modify the Investment Policy. This task was given to Jay Castellano and Chuck Sklader, SST Benefits. Cheryl Boston has gone through the Investment Policy and compiled all work done to date into a single document. Bill Tugaw suggested that each page of the document be reviewed and discussed.

Bill Tugaw led the Subcommittee through the following changes:

NOTE: If you have any questions or concerns, please contact Cheryl Boston at (408) 975-1465

Page 2: The table of contents will be modified at the end of the Subcommittee's review. A Description of Investment Option Categories has been added to the table of contents.

Investment Philosophy has been updated to include a new paragraph to explain the importance of diversification.

Page 5: Member Busse questioned the change of the average portfolio quality in a Bond Option from AA to a range from AAA to BB. Member Busse explained that a BB rating for an average portfolio quality seems low. Member Cooper added that this range was below investment grade. Member Busse stated that to get an average of BB, the portfolio would have too many inappropriate funds in the portfolio. Member Busse suggested that the intent of the original change may have been to expand the range of the funds contained within the portfolio rather than to provide an overall average credit quality for the portfolio. Member Busse and Member Cooper felt that the Committee wouldn't want an overall average portfolio quality of BB.

Member Busse asked Bill Tugaw to share what was previously discussed with regards to changing the portfolio rating. Bill Tugaw stated that the restriction of the Bond Option fund was too high and the intent was not to do a fund with an average portfolio of BB, but to permit individual funds within a BB to be offered within the portfolio. This would permit the bond fund to receive a little higher yield. Member Busse asked SST to bring back information about what is in the current bond options.

Page 5: Guaranteed Equity Trust language was deleted. This was a product that ING formerly offered and it is no longer available.

Page 5: Member Busse asked whether the Deferred Compensation Program would be able to offer realty funds. Bill Tugaw stated that the Investment Policy was originally designed to not offer specialty or sector funds. As the Investment Policy now permits specialty and sector funds, an option under the Investment Option categories should be added to include specialty and sector funds. Originally, the addition of self-directed funds was to permit members to access specialty and sector funds. However, the push from members to also include a "green" fund led the Committee to also add a specialty fund. One of the additional language changes (later in the document) is to add language to deal with the addition of an SRI (Socially Responsible Investment fund).

Member Busse stated that on the pension side, everyone has realty funds and that it helps to keep the investment afloat in the bad years. Realty funds are different from home equity. Realty funds invest in large real estate holdings, such as hotels and shopping centers; these holdings are located all over the world. Member Cooper added that realty investments are long-term investments.

Bill Tugaw stated that SST's philosophy is that adding more funds isn't better. The more funds you give participants, the more confused they can become and this can move participants to inaction. There's a balance to achieve so you have an appropriate number of funds but also meet the need to diversify. If you add too many specialty and sector funds, you can easily increase your fund offering from 25 to 35 or 40 funds.



Member Cooper cited that many participants are only invested in 4 or 5 funds, when there are more than 20 funds available. Participants aren't using the funds currently available to them. It's evident that it's overwhelming at some level since people aren't utilizing all of the funds available to them. Bill Tugaw stated that about 70% of participants are invested in Large Cap, which is what you would expect to see.

Member Busse asked if there is a reference to the self directed funds. She believes that it isn't common knowledge that participants can invest in other (non-core) funds through this option. Bill Tugaw stated that the Policy does not get into that level of detail. Member Busse and Member Cooper discussed whether additional funds should be added and determined that the more sophisticated investors who need to move away from the core options should be directed to specialty and sector funds through the self directed options.

Bill Tugaw advised that the letter the participants sign to participate in the self directed funds indicates that the member understands the risk of these types of funds. All participants should have signed this letter. Cheryl Boston clarified that only 50% of the participants have signed this letter. Those participants who have not signed the letter may only sell the self directed funds, but may not purchase additional self directed funds. Jeanne Groen stated that participants who have not responded to the letter are being called individually by ING.

According to Bill Tugaw, defining an SRI (socially responsible investment) is difficult as there are so many directions an SRI could go, such as alcohol. Member Taylor asked that the self directed fund language be expanded so that participants would understand that specialty and sector funds are available to them.

Bill Tugaw asked the Committee if they wanted to consider the SRI funds based on individual fund investments. Member Taylor asked how many participants are participating in the SRI currently offered. Bill Tugaw stated that 67 people have invested \$715,000. Member Busse supported the idea that fund performance of SRIs be based on two separate criteria; one for performance and one for whether a fund is investing in a socially responsible manner.

Bill Tugaw pointed out that the language on page 12 was added to address how to measure the SRI fund and suggested that the deleted language on page 12 should be added back to the Investment Policy to help the Committee deal with any adverse fund performance. Member Cooper encouraged the Committee to approach the SRI funds from a fiduciary standpoint. Member Busse agreed that only funds performing well will be offered. All Committee Members agreed that the options on page 5 and 6 should be expanded with the generic language on SRIs on page 12; that the criteria should include the deleted language on page 12 and that an SRI should be judged on overall fund performance compared to the relevant asset class. The Self Directed Brokerage Options will be used to meet individual investor's needs if an SRI's fund performance isn't competitive in its specific asset class.

Page 11: Committee agreed to change the number of Money Market funds from a minimum of 1 fund to a minimum of 0 funds. Currently, participants are not restricted in moving their money out of the Stable Value fund, so a Money Market fund is not



necessary with the current provider. This change better reflects the Plan's current core options.

Page 13: Member Busse questioned the language used in the Initial Screening. Member Cooper suggested using five of the most recent one year periods. Bill Tugaw receives information for each quarter and can provide this information to the Committee. Member Busse asked how SST would perform the initial screening. Bill Tugaw stated that he would be able to manually assess five of the most recent one year periods. However, Bill would not be able to do an appropriate peer group comparison as this information is not available through Morningstar. Bill Tugaw asked if the Committee would be comfortable revising the initial screening to the one-, three- and five-year periods so that the initial screening would mirror the peer group comparison information. The Committee agreed to this change.

Member Busse suggested that the funds should out perform in each of the one-, three- and five-year periods. Bill Tugaw suggested that the Committee may have trouble getting a fund to out perform in all three of the one-, three- and five-year categories and suggested that the Committee have a screen of out performing in 2 of the 3 categories. Bill Tugaw also suggested adding some discretionary authority language to widen the screening if no funds are able to meet the initial screening criteria

Page 19: For the Investment Fund Evaluations, Member Busse suggested that the Committee should spend more time reviewing the criteria. Bill Tugaw suggested a full meeting to discuss this criterion in more detail. Member Cooper suggested that SST bring in examples of the different evaluation tools for the Committee to evaluate.

Next steps will be:

- a. Remainder pages, pages 19 through 24, to be reviewed.
- b. Investment Fund Evaluation criteria will be reviewed.

PUBLIC COMMENTS

None.

ADJOURNMENT

M.S.C. (Busse/Taylor) to adjourn meeting.

D. Busse

Donna Busse
Investment Subcommittee Member

Julia H. Cooper

Julia Cooper
Investment Subcommittee Member

Conrad Taylor

Conrad Taylor
Investment Subcommittee Member

